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IN THE

Supreme Court of the United States

OCTOBER TERM, 1980

No. 80-11

J. GREGORY MERRION AND ROBERT L. BAYLESS, d/b/a/ MERRION AND BAYLESS, *et al.*, *Petitioners*,

v.

JICARILLA APACHE TRIBE, JICARILLA APACHE TRIBAL COUNCIL, AND CECIL ANDRUS, Secretary of the Interior, *Respondents*.

No. 80-15

AMOCO PRODUCTION COMPANY, AND MARATHON OIL COMPANY, *Petitioners*,

v.

JICARILLA APACHE TRIBE, *et al.*, and CECIL ANDRUS, Secretary of the Interior, *Respondents*.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

SUPPLEMENTAL BRIEF OF RESPONDENT JICARILLA APACHE TRIBE

Of Counsel:

B. REID HALTOM
MARCIA L. GREEN
NORDHAUS, HALTOM & TAYLOR
200 Lomas Blvd., N.W.
Suite 810
Albuquerque, New Mexico 87102
Telephone: (505) 243-4275

TERRY D. FARMER
MOSES, DUNN, BECKLEY, ESPINOSA & TUTHILL
200 Lomas Blvd., N.W.
Suite 800
Albuquerque, New Mexico 87102
Telephone: (505) 843-9440

ROBERT J. NORDHAUS
NORDHAUS, HALTOM & TAYLOR
200 Lomas Blvd., N.W.
Suite 810
Albuquerque, New Mexico 87102
Telephone: (505) 243-4275
Counsel of Record for Respondents Jicarilla Apache Tribe, et al.

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SUPPLEMENTAL BRIEF

This Supplemental Brief is submitted in view of the pending reargument of this case. The purpose of the Brief is to examine recent court decisions not previously considered and the deficiencies in federal supervision of oil and gas leases on Indian lands which have recently received widespread national attention. Respondent submits that failure of government agencies to provide adequate supervision of oil and gas operations on Indian trust lands emphasizes the need for tribal action to enforce oil and gas regulations and compliance with

lease provisions, and for tax revenues to enable tribal governments to provide this protection of tribal resources. Respondent endorses the arguments of the Secretary of Interior in the Secretary's Supplemental Brief filed in August 1981, and respectfully refers to the Tribe's Brief in Opposition to the Petition for Certiorari and Response Brief filed in this case.

I

Tribes With Mineral Resources Need Tax Revenues to Enforce Leases, Protect Reservation Environments, And Prevent Fraud And Theft In Connection With Oil And Gas Production

A. *The National Problem*

The nationally publicized scandal on the Wind River Reservation in Wyoming brings to public attention a condition which has existed for many years: that is, the failure of the Department of Interior to monitor and enforce lease provisions effectively on federal and Indian lands. Hearings were conducted in February, April and June, 1981, by the Select Committee on Indian Affairs of the United States Senate on "Federal Supervision of Oil and Gas Leases on Indian Lands". The statement of Senator Melcher, filed with this Brief as Appendix I, summarizes the record of maintenance of unapproved oil storage facilities, unapproved metering systems, apparent fraudulent run tickets and fraudulent operation of wells, probable oil thefts, and more important, the failure of agencies of the Department of Interior to correct these problems over a number of years. The statement of Senator Melcher is supported by an extensive record including statements of officials of the United States Geological Survey (USGS), official reports of oil field inspections, and correspondence with oil companies. (*See Hearings*, April 6, 1981, Part 2, pp. 209-294) [1]

[1] It is submitted that this Court may take judicial notice of statements of officials of branches of the Executive Department when these statements relate to records under their control; also as to

As a result of the evidence obtained by the Select Committee on Indian Affairs of the Senate, Secretary of Interior James G. Watt established an independent *Commission on Fiscal Accountability of the Nation's Energy Resources* to examine all relevant issues and submit findings and recommendations for stopping waste and theft associated with oil and gas production on Indian and federal lands. The first hearings before this Commission were held August 27th and 28th, 1981. Of particular interest is the statement of Milton J. Socolar, Acting Controller General of the United States on August 27, 1981 before the Commission, a copy of which is attached to this Brief as Appendix II. Mr. Socolar pointed out that numerous General Accounting Office (GAO) and Department of Interior audit reports had identified the need for improved management of USGS royalty accounting systems since 1959. The

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statements of government agents, at hearings before independent governmental commissions such as the Commission on Fiscal Accountability of the Nation's Energy Resources. The reports and statements of witnesses before this Commission and the Senate Committees are not submitted as proof of the specific facts stated, only as to the general conditions which have had widespread publicity in the press and television and which are of great concern to the nation. The situation is similar to that considered by the Court of Appeals for the Fifth Circuit in the *Southern Louisiana Area Rate Cases* v. *Federal Power Commission*, 428 F.2d 407, 438, fn. 98 (5th Cir. 1970), in which the Court took judicial notice of public speeches of the Commissioners of the FPC as to the seriousness of the energy supply problem:

> We take judicial notice of the concerns these speeches express (citation omitted). (We do not, of course, take judicial notice of the specific facts they state for the purpose of resolving contested issues. *Id.*)

See also *Heath* v. *Wallace*, 138 U.S. 573, 578 (1891) (judicial notice of official statements made by the head of one of the branches of the Executive Department); *National Labor Relations Board* v. *E.C. Atkins & Co.*, 331 U.S. 398 (1947) (circular issued by military authorities); *Tempel* v. *United States*, 248 U.S. 121 (1918) (reports of the Secretary of War); *Clappier* v. *Flynn*, 605 F.2d 519 (9th Cir. 1979) (publication in the Federal Register relating to hospital rates).

Office of Controller General determined that the problems not only persist but have become worse in that lease account records still contain numerous errors and omissions; collection procedures are inadequate; lease accounts are still not audited on a routine basis; and unverified data are still used to compute royalties. Because of insufficient lease inspections and monitoring by the USGS, violations of regulations on federal and Indian leases — including the use of resettable meters and improperly sealed meters on storage tanks — have gone undetected.

Mr. Socolar also stated that at the time of the current review, the USGS had only 47 inspectors to review the activities of over 44,000 producing wells (App. II, p. 12a); further, automated royalty accounting system had broken down with the result that some 27,000 lease account records are inaccurate and unreliable (*Id.* at 13a). He further stated:

> In our April 1979 report, we disclosed that in 1977 alone Geological Survey did not collect about $359 million in oil and gas royalties when due. (*Id.* at 12a).
>
> On an annual basis $390 million in royalty payments may have been paid late, costing the Treasury potentially $1.6 million in additional interest cost. (*Id.* at 16a).

B. *Enforcement Action Taken By The Jicarilla Apache Tribe*

Faced with similar problems, the Jicarilla Apache Tribe made demands on the Secretary of Interior to enforce various lease provisions as early as 1973, and in 1975 and 1976 initiated litigation against a number of the major oil and gas producers on the reservation and the Secretary of Interior to enforce compliance with lease terms. The action of the Tribe was noted by Judge Edwin L. Mechem of the United States District Court, District of New Mexico, in his Opinion in *Jicarilla Apache Tribe* v. *Supron Energy Corp.*, 479 F.Supp. 536, 540 (1979). The Court said:

> Prior to the institution of this action, the Tribe demanded in 1973 that the Secretary take appropriate and necessary action to make determinations required of him under the

terms of the lease and to require lessees to perform their obligations as denominated in the lease provisions. The Tribe has continued to demand action of the Secretary since 1973. When it became clear to the Tribe that, in its opinion, its demands would not be heeded by the Secretary, it instituted this action in 1975. In addition to its demands on the Secretary, the Tribe has previously demanded of defendants-lessees that they pay royalties on gas produced based on actual value of such gas, that they account separately for liquid hydrocarbon substances as required by the lease terms, that they drill such offset wells as are necessary to protect lease lands from drainage, and that they exercise reasonable diligence in the development of oil and gas, while products can be secured in paying quantities, of leases held by these lessees on Reservation lands.

In the *Supron* case, the Tribe settled with Southern Union Gas Company and Southern Union Gathering Company. *See* 479 F.Supp. at 538. The Tribe's common law claims against the other Defendants — Supron, Southland Royalty Company and Exxon Co., U.S.A. — were upheld by the Court. The Court made extensive findings as to breach of fiduciary obligation by the Secretary with respect to failures to require diligent development of leases (*Id.* at 547); to protect tribal leases from drainage by requiring the drilling of offset wells (*Id.* at 548); and to require accurate accounting for value according to the terms of the leases (*Id.* at 551-52). Final judgment assessing additional royalties against the corporate Defendants was entered in that case June 1, 1981, and is now being appealed by all the parties to the Court of Appeals for the Tenth Circuit.

During the pendency of the *Supron* case and other cases, the USGS Supervisor in Albuquerque assessed additional royalties against a number of the companies based on determinations of value of gas higher than that reported by the companies. The action of the Supervisor was appealed to the Commissioner of Indian Affairs and then to the Interior Board of Land Appeals. Action of the Supervisor was upheld by the Board of Land Appeals in a decision important for

tribes throughout the country in establishing standards for determining value of royalties and requiring initiation of a dual accounting system for gas and liquids extracted from gas from those producers operating liquids extraction plants. 79 IBLA 374, March 21, 1980. The companies have filed suit for review of that decision under the Administrative Procedure Act, 5 U.S.C. §§ 701-706, in the United States District Court, District of New Mexico.

Costs to the Tribe of enforcing lease provisions because of the failure of the agencies of the Department of Interior to do so have been substantial. A question was posed at oral argument before the Court in March as to why tribes had not exercised the power of tax until recently (Tr. at 33). In answer to this question, it is submitted that tribal powers to regulate activities on reservations and to levy taxes to support governmental services have not been exercised because tribal officials have believed until recently that the Bureau of Indian Affairs and other agencies of the Department of Interior were providing needed services, and protecting and conserving reservation lands and resources. The record shows that this protection has been lacking, not only on the Jicarilla Apache Reservation, but on Indian lands throughout the United States. This has required the tribes to develop at their own expense programs for lease enforcement and conservation and has necessitated the imposition of taxes to support those governmental programs. *See also* Respondent's Brief in Opposition to Petition for Certiorari herein, pp. 4-5.

The substantial reductions in funding for the BIA and other agencies of the Department of Interior under the Omnibus Budget Reconciliation Act of 1981 will compound existing problems. *See* House Report No. 97-208, 97th Cong. 1981.

II

The Authority of The Jicarilla Apache Tribe to Levy a Severance Tax Upon The Production of Oil and Gas by Non-Member Lessees On The Reservation is an Inherent Sovereign Power of The Tribe Reaffirmed, Not Divested, By Congress

The power of Indian tribes to tax, including power to tax non-Indians conducting activities on the reservation, is a power of tribes which has been recognized by the courts for almost 100 years. *Washington* v. *Confederated Tribes of the Colville Indian Reservation*, 447 U.S. 134 (1980); *Morris* v. *Hitchcock*, 194 U.S. 384 (1904); *Barta* v. *Oglala Sioux Tribe*, 259 F.2d 553 (8th Cir. 1958), *cert. denied*, 358 U.S. 932 (1958); *Iron Crow* v. *Oglala Sioux Tribe*, 231 F.2d 89 (8th Cir. 1956); *Buster* v. *Wright*, 135 F. 947 (8th Cir. 1905), *appeal dismissed*, 203 U.S. 599 (1906); *Maxey* v. *Wright*, 54 S.W. 807 (1900), *aff'd.*, 105 F. 1003 (8th Cir. 1900).

This Court in *Washington* v. *Colville*, *supra*, at 152 (1980), delineated the extent of tribal power to tax as follows:

> The power to tax transactions occurring on trust lands and significantly involving a tribe or its members is a fundamental attribute of sovereignty which the tribes retain unless divested of it by federal law or necessary implication of their dependent status.

The Court further stated at pages 156-157:

> While the Tribes do have an interest in raising revenues for essential governmental programs, that interest is strongest when the revenues are derived from value generated on the reservation by activities involving the Tribes and when the taxpayer is the recipient of tribal services. The State also has a legitimate governmental interest in raising revenues, and that interest is likewise strongest when the tax is directed at off-reservation value and when the taxpayer is the recipient of state services.

In this context, the Court of Appeals for the Ninth Circuit in *Crow Tribe of Indians* v. *Montana*, 650 F.2d 1104, 1117 (9th

Cir. 1981), evaluated the impact of Montana's 30% severance tax on coal production on the Crow Reservation and stated:

> In this case revenue sought to be taxed by Montana may ultimately be traced to the Tribe's mineral resources, a component of the reservation land itself. This is not a case where the tribe is simply marketing a tax exemption, as where tribes seeks to sell tax-free cigarettes to non-Indians. Any substantial incursion into the revenues obtained from the sale of the Indians' land-based wealth cuts to the heart of the Tribe's ability to sustain itself.

It is submitted that the power and authority to tax non-member activities, as applied to a particular tribe, must be appropriate to the activities conducted by non-Indians on reservation lands in each case. It is futile for the Tribe to levy a manufacturer's excise tax, if there is no manufacturing on the reservation; or a tax on logging operations or the sale of timber if there is no logging or timber operation on the reservation; or a retail sales tax if there are no retail stores of consequence on the reservation; or permits for fishing and hunting if there is no fishing or hunting.

Non-Indians operating businesses on reservations complain that tribal taxes imposed upon them are not within tribal powers. In particular, Petitioners in this case also argue that a tax must be consensual where the taxpayer is already on the reservation under a valid business license, lease or contract. These Petitioners misread the doctrine of this Court as stated in *Colville* and redefined in *Montana* v. *United States*, ____ U.S. ____, 101 S.Ct. 1245, 1248 (1981) in arguing:

> The analysis of tribal rights over non-members in the tribe was discussed in Montana v. United States and is applicable to our case. Petitioners entered into a consensual relationship with the tribe. A contract which imposed the conditions of their entry and fixed the conditions for them to remain, that the royalties would be paid and provided that the rents and royalties could never be increased. (Oral Argument, March 30, 1981, Tr. 8)

Petitioners, throughout their briefs and their arguments before the Court in March of 1981, confuse the concept of consensual relationship with the Tribe or its members as stated in *Montana* v. *United States, supra,* with a concept that the taxpayer must consent to this tax. This novel argument, reinforced in their own minds by their refusal to appreciate the role of Indian governments, and their incorrect reading of this Court's decisions, is a corollary of the argument that the tribes have only a proprietary power of a landlord to place conditions on entry of non-members onto reservation territory. Once legally inside the reservation boundaries, the argument goes, these non-members have a constitutional right to operate without restrictions under the leases, contracts, licenses or other arrangements with the tribes, that their privileges are unlimited in scope and time, and the tribes have lost their power to exclude them from reservation territory or control their activities in any manner whatsoever, except for violation of a specific lease provision.

Counsel for Amoco also seek to subvert the *Colville* doctrine that the power to tax transactions occurring on trust lands significantly involving the Tribe is a fundamental attribute of sovereignty, and the principle enunciated in *Montana* v. *United States* that the Tribe may regulate through taxation the activities of non-members who enter "consensual" relationships with the Tribe or its members through commercial dealing, contracts, leases or other arrangements, by arguing that the tribes no longer have a significant interest in the lands leased to Petitioners. Counsel for Amoco stated at oral argument before this Court in March, 1981:

> But the tribe's interest, insofar as this case is concerned, has been assigned for the term of the lease and the conditions under which the petitioners are entitled to remain was spelled out in both leases, and the tribe retains no significant interest which would justify the tax in this case as was the situation in Colville. Any remaining interest would not support that conclusion. (Tr. 10.)

The oil companies would not have the temerity to advance this argument with respect to operations of lessees under state

or federal leases. They would surely concede the continuing interest of other governments in conservation of lands and resources, including the subsurface groundwater, use of the surface and the air above, and the economic well-being and general welfare of the people residing on these lands. Petitioners continue to show their contempt for Indians and Indian governments by challenging the right of Indians to take action to protect their lands, their resources and their people, even where actions of lessees threaten the "political integrity, the economic security, or the health or welfare of the Tribe." *Montana* v. *United States, supra,* at 1258.

This contempt for Indians was first exhibited by the Merrion and Bayless Petitioners when they quoted with approval from a law review in a brief filed in District Court (R. Vol. I at 46):

> "Indians do not require oil to carry on their traditional economic and social activities. There is nothing about Indian culture which contributes to the value of oil or which should instill in Indians an appreciation for the substance, apart from the revenue it provides. Oil conservation is the vital concern of the white public, not the Indian, and the accident of the oil's location beneath public lands set apart for Indians does not reduce the need for it's conservation in the interests of white culture."

The attitude of the oil companies toward Indians and Indian governments has not changed over the years. The gist of their argument is that tribes do not and should not possess the authority to protect their resources or their people from actions of non-Indian outsiders, because the protection afforded by the Department of Interior and other agencies of the United States Government provides adequate security to the tribes.

As set forth in Argument I above, however, the agencies of the United States Government with the trust responsibility for protection of tribal lands and resources have failed over the years in fulfilling their trust obligation to the tribes, and the tribes must rely on their own initiative and funds to enforce lease obligations and to protect their lands, resources and people.

Although the companies will surely argue that there is no evidence admitted into this record establishing fraud, theft or irregularities on their part, the extensive record spanning many years of admitted failures of government agencies effectively to supervise oil and gas operations, is a matter of legitimate concern to the nation and as well as to the Indian tribes. Millions of dollars worth of easily transportable oil and drip gasoline, stored in tanks in isolated areas on reservation lands, are a tempting target, day or night, for disloyal company employees or outsiders. A 5,000 gallon tank truck can pick up in an overnight excursion over 100 barrels of oil or drip gasoline worth $3,000 to $4,000. Without the help of tribal employees and tribal police, neither the federal agencies nor the companies themselves can effectively prevent fraud and theft. Responsible officials of the USGS recognize the need for cooperative programs between the states, Indian tribes and the federal government so as to limit the potential for theft or mishandling of crude oil (see statement of Dwayne Hull, Manager, North Central Region, Conservation Division, USGS, Senate Hearing, *supra*, Part I, p. 74). Petitioners should welcome the help of tribal employees, police and inspectors and support taxation by tribes to make this assistance possible.

III

Tribes Need And Are Entitled To Tax Revenues To Provide Governmental Services For Tribal Members And For Non-Members Residing Or Conducting Business On Reservations

A. *The Tribal Government Provides Substantial Governmental Services Benefitting Petitioners.*

Federal policy toward Indian tribes now favors self-determination rather than assimilation, and Indian tribes must exercise power to tax in order to support their governments. *See* the Indian Reorganization Act of 1934, 25 U.S.C. §§ 461 *et. seq.;* Indian Self-Determination and Education Assistance Act of 1974, 25 U.S.C. §§ 450 *et seq.;* Natural Gas Policy Act of 1978, 15 U.S.C. § 3320.

The Jicarilla Apache Tribe and other tribes provide substantial governmental services to non-members conducting activities on reservations, including oil and gas lessees. The evidence is uncontroverted that the agencies of the State of New Mexico provide very little service on the Jicarilla Apache reservation. (Testimony of Richard TeCube, R. Vol. VI at 263). The Tribe's Response Brief, pp. 7-8, outlined the testimony and exhibits tendered by the Tribe but denied admission as to the operation by the tribal government of a police force of more than 20 uniformed policemen with a budget paid out of tribal funds of $184,068 in fiscal 1976, compared to one New Mexico state police officer whose budget was $11,000; evidence that would have established that the Tribe furnished various services, including the operation of a community center open to Indians and non-Indians (R. Vol. VI 301-02, Den. R. 305, 306); and other services. (*Id.* at 283-84). A specific tender of proof was offered with respect to road maintenance on the reservation with the tender that the road maintenance benefits the Plaintiffs in their oil and gas operation under their leases. (*Id.* at 284, denied, *Id.* at 290). Under the doctrine enunciated in *Commonwealth Edison Co.* v. *Montana,* 101 S.Ct. 2946, 2959 (1981), no factual inquiry "into the relationship between the revenues generated by a tax and costs incurred on account of the taxed activity" is necessary to validate the tax. All that is required is that the tax be reasonably related to the taxpayers' activities or presence in the jurisdiction. Recognition of the relationship here between the Jicarilla Apache tax and the impact costs of the activities of these oil companies is inescapable.

Petitioners argue that the Tribe should expend its royalty income to provide governmental services which benefit lessees as well as tribal members. Amoco counsel argued before this Court that the record "shows that the royalty revenue to the tribe more than supports the entire tribal government" (Oral Arg., March 30, 1981, Tr. 44), an argument which seems to assert that the Tribe should assume substantial portions of the cost of exploration, development, produc-

tion, conservation and prevention of waste, environmental protection and reclamation connected with Petitioners' operations and pay these out of royalties. The theory would deny to individual tribal members the benefit of a large portion of the royalties. In view of the dire poverty of most Indians (see Respondent's Brief on Petition for Certiorari, p. 6), this position is untenable.

It is submitted that the rule in *Ford Motor Co.* v. *Beauchamp*, 308 U.S. 331, 334-335 (1939), that the "exploitation by foreign corporations of intrastate opportunities under the protection and encouragement of local government offers a basis for taxation as unrestricted as that for domestic corporations" is applicable to tribes as well as states. The doctrine of this Court that persons and corporations conducting activities within a state are required to contribute to the general cost of providing governmental services, as distinct from those costs attributable to the taxed activity, should also pertain to Indian reservations. The Jicarilla Apache Tribe, not the State of New Mexico, provides the majority of governmental services on the Jicarilla Apache Reservation, and it is not disputed that Petitioners demand and enjoy the benefits of these services.

B. *Tribal Power To Tax Has Not Been Preempted Or Divested.*

The oil companies argue that tribal power to tax, if it existed, has been preempted or divested by state taxing authority conferred by Congress in the 1927 Leasing Act, 25 U.S.C. § 398c, and further, that the comprehensive federal regulatory scheme pertaining to oil and gas leasing and operations preempts tribal regulation or taxation. A careful analysis reveals, however, that the Mineral Leasing Act of 1938, 25 U.S.C. §§ 396a-396g, under which the leases in suit were issued, established an entirely new philosophy of leasing and regulation of oil and gas operations on Indian land based on the objectives of the Indian Reorganization Act, 25 U.S.C. §§ 461 *et seq.* (1934). In fact, 25 U.S.C. § 398c is inapplicable to leases issued under the 1938 Act. See Response Brief, pp. 31-35.

The Ninth Circuit Court of Appeals in the recent case of *Crow Tribe of Indians* v. *State of Montana, supra,* decided July 13, 1981, in considering the question whether Montana's 30% severance taxes on reservation coal infringed on the Tribe's right to govern itself, analyzed the Mineral Leasing Act of 1938 as follows:

> The 1938 Act (footnote deleted) was designed to achieve three goals. (Citing legislative history) First, the Act sought to achieve uniformity in the law governing mineral leases on Indian lands. Prior law had been a statutory hodgepodge that imposed different requirements for mineral leases on different Indian lands. (footnote deleted) Second, the 1938 Act was designed to help achieve the broad policy of the Indian Reorganization Act of 1934, 25 U.S.C. §§ 461-479 (1976), that tribal governments be revitalized. In the mineral leasing context, this meant giving tribal governments control over decisions to lease their lands and over lease conditions, subject to approval of the Secretary of Interior, where before the responsibility for such decisions was lodged in large part only with the Secretary. (footnote deleted). Third, the 1938 Act was intended to encourage tribal economic development, an important objective of the Indian Reorganization Act of 1934. Prior to the 1938 Act, the leasing of Indian lands for mining purposes was governed by mining laws applicable to public lands generally. Technical requirements and complicated procedures under these laws had prevented the leasing of much of the Indians' land, thus depriving them of considerable revenue. (Citing legislative history) The 1938 Act provided that land was to be leased by the Indians on terms restricted only by regulations to be adopted by the Secretary pursuant to the Act. 650 F.2d at 1112-1113.

The Court of Appeals, in the instant case, also pointed out that Congress has expressly provided that tribes, like the Jicarilla Apache Tribe, may by constitutional or legislative means approved by the Secretary of Interior, set the terms upon which they would lease their lands and regulate the operations of the lessees (citing 25 U.S.C. § 396b). The Court also noted that 25 C.F.R. §171.29 provides that regulations pertaining to oil and gas leasing and operations "may be superseded by the

provisions of any tribal constitution, by-law or charter issued pursuant to the Indian Reorganization Act of June 18, 1934 (citing), . . . or by ordinance, resolution or other action authorized under such constitution, by-law or charter". The Court further stated: "[u]nder these circumstances we cannot conclude that Congress intended to so occupy the field of regulating leasing of tribal property for oil and gas leases that the Tribes could not impose additional burdens on lessees through exercise of the power of taxation." J.A. 160-161.

This Court has never interpreted ambiguous congressional acts to divest sovereign powers by implication. *See White Mountain Apache Tribe* v. *Bracker*, 448 U.S. 136 (1980); *Santa Clara Pueblo* v. *Martinez*, 436 U.S. 49 (1978); *Bryan* v. *Itasca County*, 426 U.S. 373 (1976); see Response Brief, pp. 27-31. The question of state power to levy severance taxes on non-Indian interests in production of oil and gas on tribal lands is not before the Court in this case. But if the Court is concerned about the impact to both state and tribal taxes, then the particularized inquiry mentioned in *White Mountain Apache Tribe* v. *Bracker*, *supra*, seems to be appropriate:

> More difficult questions arise where, as here, a State asserts authority over the conduct of non-Indians engaging in activity on the reservation. In such cases we have examined the language of the relevant federal treaties and statutes in terms of both the broad policies that underlie them and the notions of sovereignty that have developed from historical traditions of tribal independence. This inquiry is not dependent on mechanical or absolute conceptions of state or tribal sovereignty, but has called for a particularized inquiry into the nature of the state, federal and tribal interests at stake, an inquiry designed to determine whether, in the specific context, the exercise of state authority would violate federal law. 448 U.S. at 144-45.

The Tribe submits that the inquiry should focus on present day conditions and policies encouraging tribal self-determination rather than those which prevailed many years ago when Congressional policy favored termination of tribal entities and assimilation of tribal members with the general population. It

should be clear from this examination that the Tribe's power to tax the major activity on its lands which has significant impacts on the reservation is retained under the doctrine of *Colville, supra* and *Montana* v. *United States, supra.* The particularized inquiry in this case would have to be based on evidence in the record and evidence tendered by the Tribe since Petitioners failed to build a factual record which would support either divestiture or preemption of tribal authority.

IV

The Jicarilla Apache Severance Tax Does Not Violate The Commerce Clause Of The United States Constitution

A. *Claims Of Discrimination Against Interstate Commerce Are Without Substance.*

The oil companies' claim of discrimination between intrastate and interstate commerce is not supported by the evidence. Their claim is based on presumed discrimination in favor of *reservation commerce* as against *off-reservation commerce.* Their claims of discrimination are based on possible sales of oil or gas by the Tribe for consumption on the reservation for potential industrial use, which they say would result in prohibited discrimination in favor of users of the Tribe's royalty gas on the reservation as against off-reservation consumers or industries either in the State of New Mexico or outside the State of New Mexico. They conceded in oral argument that there was no discrimination at the present time (Tr. 15). Even if tribes were held to the same standards of non-discrimination against off-reservation commerce by the Indian Commerce Clause as the states are with respect to interstate commerce, the Commerce Clause would not limit the tribes' proprietary operations. See *Reeves, Inc.* v. *Stake,* 447 U.S. 429 (1980); *Hughes* v. *Alexandria Scrap Corp.,* 426 U.S. 794 (1976); *Hudson County Water Co.* v. *McCarter,* 209 U.S. 349 (1908); *McCready* v. *Virginia,* 94 U.S. 391 (1876). There is here, however, no discrimination even in favor of tribal members, who must pay the tax. As noted by the Court of Appeals (J.A. 155) the phrase "removed from tribal lands" in the

ordinance (J.A. 38) means removal from the soil, not from the reservation. The provision that the tax rate is to be applied to oil and gas "sold or transported off the reservation" means that the tax rate is applied to natural gas that is sold on the reservation or transported off the reservation before sale. The only exemption is for oil or gas used for production or received by the Tribe as royalty in kind and *used by the Tribe.* (J.A. 39). All oil and gas, including pipeline production, is measured at the wellhead. The form of Operators Remittance Report (J.A. 37) shows that the production volume is measured at the wellhead, and the tax rate and tax remitted are determined by wellhead BTU content and volume. There is no evidence whatsoever of actual or potential discrimination against off-reservation commerce. The construction of the ordinance adopted by tribal authorities should be determinative. As stated in *Hope Natural Gas Co.* v. *Hall,* 274 U.S. 284, 288 (1927):

> The plain result of the opinion and final decree is to require that the tax be computed upon the value of the gas at the well, and not otherwise. If, hereafter, executive officers disregard the approved construction and fix values upon any improper basis appropriate relief may be obtained through the courts.

The Court of Appeals viewed the District Court's reasons for holding the tax discriminatory against interstate commerce as based on the provisions exempting "royalty gas, oil or condensate taken by the Tribe in kind, and used by the Tribe" as discriminating against off-reservation commerce (J.A. 153). The Trial Court is clearly wrong. It is submitted that the District Court's conclusion of law that the tax discriminates against interstate commerce was not based on any finding which would support that conclusion, and there is no evidence in the record on which that conclusion could properly be based. Based on the record, the Tenth Circuit found no illegal discrimination in the Ordinance.

B. *The Tribal Tax Does Not Impose A Prohibited Burden On Commerce.*

The Trial Court's conclusion that the tribal tax, when added to the state tax, imposed a prohibited multiple burden on commerce, was based solely on the testimony of the witness Dugan that the total burden of the New Mexico and tribal proposed tax would be 20.4% of the price of old gas. (R. IV at 58.) The trial court accepted the proposed findings of the Petitioners and erroneously reported the combined burden to be 29% of the price of old gas. There was no evidence as to the ratio of old (low price) gas to total gas produced on the reservation or of the burden of the tax on all producers on the reservation, or of the burden on consumers, other than the report of Dr. Alfred L. Parker entitled *The Economic Impact of a Proposed Oil and Natural Gas Severance Tax*. which analyzed in detail the impact of the Jicarilla Apache severance tax on New Mexico consumers and out-of-state consumers. This study is reproduced as Appendix B to the Tribe's Brief in Opposition to the Petition for Certiorari herein and was admitted in evidence at the hearing on preliminary injunction, R. IV at 137. This evidence as to the impact of the tax, which was not rebutted, established that the tribal tax would increase the cost of gas to New Mexico consumers by 6/10ths of $.01 per MCF (App. B at 16), the cost to interstate consumers in California (a major market for interstate gas produced in New Mexico) by 3/10ths of $.01 per MCF (Id. at 18). The report stated that data was not then available to measure precisely the impact of the tribal tax on New Mexico consumers of petroleum products of the tribal tax but that it would be very small indeed (Id. at 15). As the Court of Appeals pointed out, the oil companies failed to build a factual foundation in the record herein to challenge the tax on the ground that it is not fairly related to services provided by the reservation (J.A. 154, fn.4). The Tribe's efforts to establish the relation of tribal services to the tax were objected to by Petitioners and denied by the Court as stated above.

This Court in *Commonwealth Edison Co.* v. *Montana, supra,* held that the Montana 30% severance tax should be evaluated under the test set forth in *Complete Auto Transit, Inc.* v. *Brady,* 430 U.S. 274, 279 (1977), whereby the Court stated that a state tax does not offend the Commerce Clause if it "is applied to an activity with a substantial nexus with the taxing State, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the State." The Court said that the fourth prong of the Complete Auto Transit test requires only that the measure of the tax be reasonably related to the extent of the taxpayer's contact with the state and as a general tax. The Montana tax was in proper proportion to Commonwealth Edison's activities within the state and therefore to its enjoyment of the opportunities and protection which the state has afforded in connection with those activities, such as "police and fire protection, the benefit of a trained work force, and the advantages of a civilized society", quoting from *Exxon Corp.* v. *Wisconsin Department of Revenue,* 447 U.S. 207, 288 (1980). As a general revenue tax, it need not be related to the value of services provided to the taxpayers and the only benefit to which the taxpayers are constitutionally entitled is that derived from their enjoyment of the privileges of living in an organized society established and safeguarded by the devotion of taxes to public purposes. *Commonwealth Edison Co.* v. *Montana, supra,* at 2957, 2959.

The Court expressly rejected Commonwealth Edison's suggestion that the Commerce Clause prohibits the states from requiring an activity connected to interstate commerce to contribute to the general cost of providing governmental services, as distinct from those costs attributable to the taxed activity. Petitioner's claims that the tribal tax violates the Commerce Clause because it imposes a prohibited burden on Indian commerce or interstate commerce should similarly be rejected.

V

Conclusion

For the reasons stated in this Brief and in the Tribe's original Brief, we submit that the judgment of the Court of Appeals should be affirmed.

Respectfully submitted,

ROBERT J. NORDHAUS
NORDHAUS, HALTOM & TAYLOR
200 Lomas Blvd., N.W.
Suite 810
Albuquerque, New Mexico 87102
Tel: (505) 243-4275
Counsel of Record for Respondents Jicarilla Apache Tribe, et al.

Of Counsel:
B. REID HALTOM
MARCIA L. GREEN
NORDHAUS, HALTOM & TAYLOR
200 Lomas Blvd., N.W.
Suite 800
Albuquerque, New Mexico 87102
Telephone: (505) 843-9440

TERRY D. FARMER
MOSES, DUNN, BECKLEY,
ESPINOSA & TUTHILL
200 Lomas Blvd., N.W.
Suite 800
Albuquerque, New Mexico 87102
Telephone: (505) 843-9440

APPENDICES TO SUPPLEMENTAL BRIEF OF RESPONDENT JICARILLA APACHE TRIBE

APPENDIX 1

OIL AND GAS LEASES ON INDIAN LANDS
(PART 2)

HEARING
BEFORE THE
SELECT COMMITTEE ON INDIAN AFFAIRS
UNITED STATES SENATE
NINETY-SEVENTH CONGRESS
FIRST SESSION
ON
FEDERAL SUPERVISION OF OIL AND GAS LEASES ON INDIAN LANDS

APRIL 6, 1981

WASHINGTON, D.C.

The Secretary right now is preparing to send out a letter to the leaders of the oil-producing tribes advising them of his concern and asking for their cooperation in dealing with the problem across the board. He is indeed committed to deal with the problem and so are we.

Mr. Chairman, we will try to answer whatever questions you have.

Senator GORTON. Thank you, Mr. Frederick.

Senator Melcher has an opening statement to make. We will permit him to make that now and then we will begin the questions.

Senator Melcher?

STATEMENT OF JOHN MELCHER,
A U.S. SENATOR FROM THE STATE OF MONTANA

Senator MELCHER. Thank you, Mr. Chairman.

Mr. Frederick, I am not sure how long you have been in your present position, so the statement I am making probably does not refer to your duties nor does it refer very much to Secretary Watt, whom we thought was going to be present to give us his views on this matter.

Whatever has gone wrong with USGS procedures, it cannot be very easily laid at the doorstep of this new Secretary of the Interior who has only been in the saddle for a month or so.

Secretary Watt is not here. I hope he is pursuing with vigor what he told me in my office prior to our February 27 hearing in Billings on this subject. I hope he is attempting to get on top of this subject.

I personally have been looking forward to having Secretary Watt make the same statements on public record that he made in my office on his willingness to immediately pursue all the deficiencies and the lack of attention by the U.S. Geological Survey in monitoring and overseeing the production of oil, from not only Indian leases, but from Federal leases.

I would say right at the outset that in my judgment, whatever is wrong at Wind River and oil thefts is only the pattern for what can be wrong all over the country dealing with, not just Indian leases, but with the larger problem of what is going on with supervision and monitoring in the accounting of Federal oil leases.

We have been reviewing written memoranda by U.S. Geological Survey inspectors in Wyoming who have been reporting oil thefts as far back as the early 1970's.

I have U.S. Geological Survey documents demonstrating a pattern of neglect for almost a decade in preventing widespread practices causing failure to monitor oil production.

First, failure to use seals and locks on valves to protect against thefts;

Two, using resettable meters when sealed, nonresettable meters are required to measure the oil without tampering or changes;

Three, fear of political pressure has been noted by one or more USGS inspectors as a reason for not taking vigorous steps to accurately measure and account for oil production on Federal leases;

Four, failure by USGS officials to protect their inspectors who are threatened by violence;

Five, failure to close down wells when the lease has expired;

Six, lack of inspectors on Federal and Indian leases has been noted for 10 years while additional new employees for USGS were detailed for environmental studies of lease sites but were not responsible, nor had experience to inspect for oil production, measurement and gaging;

Seven, incidents of noncompliance were not always issued by inspectors when regulations were obviously being ignored;

Eight, incidents of noncompliance were frequently never followed up, even when there was strong evidence of opportunity for oil theft; and,

Nine, although admittedly the accounting system used by USGS is archaic, to the point of Department of Interior officials noting that accurate accounting of oil production on Indian and Federal leases cannot be ascertained, no modern computer system has been installed, although discussed since 1979.

The USGS Conservation Division has demonstrated gross inability to account for production of oil on Federal and Indian leases over a period of years and there is strong evidence of dereliction of duty by a number of their employees, and individual and perhaps collective failures to make needed corrections.

The USGS memoranda from the North-Central region district offices demonstrates very clearly that reported possible thefts of oil during the past decade did not develop a system of correction until newspaper accounts, principally from the Denver Post last summer, prompted a crash program of more inspections.

But there still remains a number of weak links in inspection and enforcement procedures that cause considerable doubt as to their capability for complete and accurate accounting and enforcement of their regulations.

Oil companies, are in control on the leases to the extent that the measurement of oil moved is often done without any supervision or checking by the USGS. Operators have developed virtual control over the day-to-day, first instance of accounting and reporting of oil produced and royalty due.

While the USGS has the responsibility and authority to verify those figures, evidence from their own memorandums indicates a pattern of failure to participate and oversee measurement, gaging and enforcement of accurate meter reading of the oil removed from Federal and Indian leases.

We assume that almost all oil operators on the leases are honest and to the extent that oil is stolen, they also lose valuable property.

While the USGS is a cop on the beat in the oilfields of Federal or Indian leases, the beats are too big — one inspection per lease per year was a goal not attained in the vast, windswept, isolated oilfields in Wyoming and Montana and other portions of the North-Central region.

As demonstrated in the USGS field memorandum over the past several years the cop — the USGS inspector — even when on the beat, is a daytime cop reluctant to be in the oilfields in the night and, in some cases, threatened physically if he required enforcement of USGS regulations.

There is a pattern of ignoring reports of noncompliance from field officials in the Casper regional office. That pattern of not enforcing regulations was known at headquarters in Reston.

Dereliction of duty by this regional office and the headquarters office of the Conservation Division in Reston is evident. The degree of negligence is yet to be determined.

The loss of royalty and lease money due the United States or Indian tribes of States has not yet been calculated. There has been a pattern within the Casper regional office of holding back tighter enforcement procedures in the district offices of the region.

We shall ask for further information today on these points and we shall note for the Justice Department any possible collusion that might warrant further investigation.

As was pointed out, this is the second in the series of hearings to be held by the Select Committee on Indian Affairs on allegations of oil theft from Indian and Federal lease land.

Today's hearing will follow up on testimony taken by the committee in Billings, Mont., on February 27. During that hearing, I requested that the U.S. Geological Survey, Conservation Division, make available to the committee all of their oil handling files in the Casper district offices.

The committee has examined and cataloged this material and will today ask the U.S. Geological Survey, Conservation Division, to explain serious discrepancies between their testimony in Billings, and data from these files.

In addition, the committee has discovered discrepancies between USGS regulations governing the inspection and monitoring of Federal and Indian oil leases and the manner in which the USGS carries out its regulatory function through enforcement actions.

The USGS files, which the committee has been sifting through, raise questions about the adequacy of Government supervision and monitoring of Indian and Federal oil resources.

The committee intends, through these hearings, to find out how oil thefts have been possible and how they can be prevented on Indian reservations and Federal lands in the future.

I would like to make it clear that the Federal Government serves as a watchdog, standing guard over Indian and public resources.

It is, therefore, a Federal responsibility to ferret out any abuse of these resources and this responsibility rests mainly with the U.S. Geological Survey and includes the verification and collection of royalties due Federal and Indian lessors and the monitoring of all phases of mineral operations.

The U.S. Geological Survey is required to inspect oil and gas well drilling, producing lease sites, abandoned mines, and oil and gas meters.

If this Federal responsibility is not being met, the victims are not only Indian tribes, but all U.S. taxpayers who are being cheated out of royalties to which the Federal Government is entitled.

In addition, the States, which are entitled to one-half of all royalties from oil and gas on public lands, would be losing their share of these royalties.

It is the committee's understanding that oil thefts from Indian lands may be occurring through various techniques, including unapproved oil storage facilities, unapproved metering systems, fraudulent run tickets, or no run tickets at all, or fraudulent reporting of wells that are not producing.

In addition, there may be misrepresentation by oil reclaimers as to the amount and type of oil being reclaimed as well as the presence of improper drainage pipes on storage tanks to bypass meters.

Uppermost among the committee's concerns is that, due at least in part to manpower and money shortages as well as possible ineptness on the part of USGS, oil companies are calling many of the shots and doing whatever they please in the oil fields.

The files submitted by the USGS to the committee show that little has been done to stop these oil operators. These records, for example, show that some oil companies go out of their way to be uncooperative.

One oil company monitored the movement of Government inspectors and radioed ahead to warn its employees that the inspectors were about to arrive. The field hands then mysteriously disappeared.

Still other records show that oil operators engage in a pattern of excuse making, foot dragging, submission of late or

incomplete reports, as well as outright threats against USGS inspectors.

However, the records go on to indicate, as will be demonstrated in today's hearing, that the USGS has not made full use of whatever authority it does have.

Abuses by oil operators are met with mild or no reprisals at all from the USGS. Violations of leasing regulations have never resulted in a cancellation of a lease.

When violations are detected records indicate that verbal or written warnings are often issued and production continues. The operator is, by regulation, required to report corrections of any violation.

The USGS files indicate that independent verification through reinspection procedures are few and far between.

It is true that the USGS is not adequately staffed. The USGS has only about 45 inspectors to check more than 37,000 producing wells on Federal and Indian land nationwide. In Wyoming alone, eight inspectors must monitor more than 8,400 wells.

Last year, a request from former Assistant Secretary Joan Davenport for a supplemental appropriation of $3 million to hire additional inspectors was killed within the Department of Interior.

These are problems which the Congress must be made aware of and must do something about. Today's hearing, as well as any subsequent hearings on this subject will assist the Indian Affairs Committee in formulating recommendations to be submitted to the Senate and appropriate Federal agencies.

These recommendations will address the need to promote good management and supervision of oil and gas leases and reduce opportunities for theft and fraud to minimal levels. This will no doubt take some time and will take a substantial investment of money.

However, I am convinced that these hearings will make it clear that accurate accountability, vigorous supervision, and strict enforcement are cost beneficial to the U.S. Government.

USGS, as has been demonstrated by the files, and as we will make clear in our hearing today, has plenty of authority which is not being exercised. We are anxious to review any recommendations for greater authority to help solve these problems.

Thank you, Mr. Chairman.

APPENDIX II

UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

STATEMENT OF
MILTON J. SOCOLAR
ACTING COMPTROLLER GENERAL
OF THE UNITED STATES
BEFORE THE
COMMISSION ON FISCAL ACCOUNTABILITY OF
THE NATION'S ENERGY RESOURCES
ON
PROBLEMS CONFRONTING THE GEOLOGICAL SURVEY IN
COLLECTING OIL AND GAS ROYALTIES

Mr. Chairman and Members of the Commission:

We are pleased to be here today to discuss our views on Geological Survey's oil and gas royalty accounting system — a system fraught with longstanding financial management problems. We applaud Secretary Watt's establishment of the Commission which is an important step to help resolve the royalty accounting problems that have plagued Geological Survey for over 20 years.

Geological Survey is responsible for collecting the royalty income derived from oil and gas produced on Federal and Indian lands. Royalty collections have increased rapidly in recent years primarily because of substantial increases in oil and gas prices. With oil prices decontrolled on January 30, 1981, this trend can be expected to continue. Annual royalties are expected to be $4 billion in fiscal 1982 and could grow to $22 billion by fiscal 1990.

In our 1979 report entitled "Oil and Gas Royalty Collections — Serious Financial Management Problems Need Congressional Attention" (FGMSD-79-24, April 13, 1979), we pointed out that Geological Survey was having great difficulty in accounting for and collecting Federal royalty income. On the basis of more recent work for the Chairman, Subcommittee on Commerce, Consumer and Monetary Affairs, House

Committee on Government Operations, we have determined that these problems persist.

Geological Survey is not collecting all oil and gas royalties; hundreds of millions of dollars owed the Government may be going uncollected each year. Moreover, millions of dollars in royalty income are not collected when due, thus increasing Government interest costs. Until Geological Survey improves its financial management, there can be little assurance that all royalty income due from Federal and Indian land is received.

We recognize that Geological Survey's task is complex and that it has to deal with many factors beyond its control such as the proliferation of lease interests, varying royalty rates, and complex oil and gas valuation factors. Also, the monetary amounts Geological Survey is responsible for, have grown tremendously in recent years.

Geological Survey is seeking to improve its financial management capabilities by developing a new royalty accounting system but it will be several years before the system is fully implemented. In order for the new royalty accounting system to be successful, a sustained, high priority effort is needed. Also, since the new system will not determine and collect previously uncollected royalties, Geological Survey needs to develop a separate plan to address this problem.

PERSISTENT MANAGEMENT PROBLEMS PREVENT ACCURATE COMPUTATION AND COLLECTION OF OIL AND GAS ROYALTIES

Since 1959 numerous GAO and Department of Interior audit reports have pointed out the need for improved management of Geological Survey's royalty accounting system. In our April 1979 report, we recommended both short-range and long-range alternatives to the longstanding financial management problems. On the basis of our current follow up work, we have determined that the problems discussed in our 1979 report not only persist, but have become worse.

In our current review we found that

—unverified data is still used to compute royalties,

—lease account records still contain numerous errors and omissions,

—collection procedures are still inadequate, and

—lease accounts are still not audited on a routine basis.

Geological Survey still relies upon unverified data

Geological Survey relies almost entirely on production and sales data reported by the oil and gas companies. There is little effort to verify the accuracy of the data supplied. Production reports are not regularly compared to reported sales; communication between Geological Survey accountants and field inspectors is infrequent; and lease inspections are not used to verify production. In short, the oil companies are essentially on an honor system to report accurately and to fully pay royalties when due. We have previously stressed that by matching production data against sales data, Geological Survey could identify situations where oil and gas produced was not properly accounted for. However, this matching is still not being routinely done.

The matching of production and sales information is a valuable tool, however, it has some limitations because of difficulties in matching this information, and because in most instances the same company prepares both reports. Therefore, Geological Survey must have a means to independently verify what is reported. As discussed in our April 1979 report, Geological Survey personnel who periodically inspect the well sites can evaluate the reasonableness of the production data. Also, production reports show the quantity on hand and can be analyzed to detect sudden changes in production quantities; thereby reducing Geological Survey's reliance on data provided by the oil and gas companies.

Our April 1979 report recommended that field inspection personnel assist accounting personnel in verifying the accuracy of the reported data by determining the reasonableness of inventory and sales data shown on production reports. Accounting personnel were to be informed of any discrepancies noted. The Geological Survey agreed and, in April 1979, issued instructions requiring communication and assistance between field inspection and accounting personnel when inconsistent or questionable data was reported. Even though the Geological Survey reported 28,283 field inspections during fiscal year 1980, there is no indication that field inspectors and accounting personnel have worked together to verify production. Geological Survey officials confirmed that they continue to accept as accurate what the companies report.

Also, there have been questions raised about the lease inspections themselves. Geological Survey's field inspections and monitoring were severely criticized at recent hearings before the Senate Select Committee on Indian Affairs. It was pointed out that because of Geological Survey's insufficient lease inspections and monitoring, violations on Federal and Indian leases have gone undetected. These violations included

—The use of resettable meters,

—Improperly sealed oil storage tanks and valves; and

—Inadequate supervision of lease operations of the oil and gas companies.

At the time of our current review, Geological Survey had only 47 inspectors to review the activities at over 44,000 producing wells. This limited number of inspectors is not sufficient to provide adequate coverage. Geological Survey should devote additional resources to the inspection effort and should require that field inspectors assist accounting personnel in verifying sales data. Production must be verified.

Lease account records contain numerous errors and omissions

Compounding the problem of Geological Survey's reliance on information reported by the oil and gas companies was the breakdown of its current automated royalty accounting system. Some 27,000 lease account records are inaccurate and unreliable. They cannot be used to determine if royalties due from Federal and Indian leases are properly accounted for. As a result, royalties due may not be collected in full and other royalties are not being collected timely. We have been reporting on the inaccuracy of lease account records since at least 1959.

Royalties earned and payments made are recorded in lease accounts through an automated accounting system using data reported by oil and gas companies. If the amounts due and the royalties paid in an account do not agree, the account will show a balance. Account balances result when companies

—make an error in computing the amount of royalties owed or amounts paid, or

—fail to pay or report royalties due.

The Geological Survey has also created erroneous account balances by recording charges or payments in wrong accounts and by making other clerical errors.

Our April 1979 report showed that as of July 1978 the lease account records contained numerous errors and could not be relied upon. Despite calling on Geological Survey to reconcile these differences, our recent follow up work shows that the lease account records are just as inaccurate and unreliable as they were in July 1978.

On July 31, 1978, the Geological Survey maintained 22,735 lease accounts. Of these accounts, only 6,569 did not have a balance. Of the accounts with a balance, 9,497 indicated that the amount paid was greater than the royalties due the Government. Although this condition can result from overpayments to the Government by the oil and gas companies, it

occurred more frequently because royalties due the Government were understated when company reports were not received and charges were not properly entered in the accounts. The balance of these 9,497 accounts was $49.8 million. The remaining 6,669 accounts which had balances indicated that royalties of $38.8 million were due because the amount collected was less than the amount computed as due.

To determine the accuracy of these accounts, we reviewed 714 randomly selected lease accounts for June, July and August 1977. We noted the following deficiencies which contributed to the inaccuracy of these lease account records

- In 137 cases, royalty payments totaling $258,000 were recorded in the accounts without amounts being recorded as due.
- In 245 cases, royalties totaling $471,000 were recorded as due without royalty payments being recorded.
- In 469 cases, the royalties due did not equal the royalties paid. Royalties paid exceeded the amounts recorded as due by $122,000.

On the basis of recent follow up work, we determined that lease accounts still are inaccurate. As of September 1980, 19,487 or 73 percent, of Geological Survey's 26,769 lease accounts had a balance. Of these, 9,962 accounts indicated that Geological Survey had been underpaid by $134 million; the remaining 9,525 accounts indicated, for the most part erroneously, that Geological Survey had been overpaid by $153 million.

Our follow up analysis of 275 of the 714 lease accounts we had previously analyzed, for the 3 months ending June 30, 1980, showed that

- In 115 cases, royalty payments totaling $725,336 were recorded in the accounts without corresponding amounts being recorded as due.

—In 97 cases, royalties totaling $276,569 were recorded as due without corresponding royalty payments being recorded.

—In 174 cases, the royalties due did not equal the royalties paid. Royalties paid exceeded the amounts recorded as due by $119,226.

It should be noted that these amounts do not necessarily represent underpayments or overpayments, but simply indicate that Geological Survey does not know the amounts due, and clearly indicate the serious problem Geological Survey has experienced in maintaining accurate lease account records. Because of incomplete and inaccurate data entered in these accounts, they cannot be used by Geological Survey to effectively manage royalty collections.

We previously called on Geological Survey to develop a plan for reconciling existing lease accounts and for identifying and collecting uncollected royalties. In June 1981, Geological Survey announced plans to audit 20 to 25 producers of oil and gas on Federal and Indian lands to determine the amount of underpayments and overpayments that have occurred. These companies cover half of the lease accounts maintained and account for over 80 percent of the royalties collected. The audits will cover lease transactions from the past 6 years and are expected to take 3 to 4 years to complete at an estimated cost of $3 million.

Because of the planned auditing project, the Geological Survey is not going to reconcile existing lease account records. We support Geological Survey's efforts to audit the oil and gas companies accounting records for the specific purpose of determining underpayments and overpayments. However, more needs to be done. Geological Survey needs also to develop a plan to reconcile its lease account records thereby providing a sounder financial base for the new royalty accounting system.

Royalties are not being collected when due

Another longstanding problem centers on Geological Survey's inability to assure that all royalties due are collected on time. Late payments continue to be a serious problem. As far back as 1959, we reported that all royalty payments were not received when due. In addition, in 1975 Department of Interior internal auditors recommended Geological Survey assess interest on late payments.

In our April 1979 report, we disclosed that in 1977 alone Geological Survey did not collect about $359 million in oil and gas royalties when due. We found payments were not received within the times specified in leases because:

—Geological Survey did not adequately enforce provisions calling for the timely payment of royalties, and

—Geological Survey did not impose appropriate administrative fees or interest charges on those making late payments.

To the extent the delayed collections involved additional borrowing by the Treasury, additional interest costs of $360,000 may have been incurred.

Late royalty payments continue to be experienced by the Geological Survey. Our analysis of 275 randomly selected lease accounts, drawn from the 714 lease accounts examined and reported on in our April 1979 report, showed that for the 3 months ending June 30, 1980, late payments totaled $98 million for that quarter alone. Had these delinquent payers been assessed interest charges equal to the cost of Federal borrowing they would have owed an additional $400,000 for the 3 month period alone. On an annual basis $390 million in royalty payments may have been paid late, costing the Treasury potentially $1.6 million in additional interest cost. It should be noted that our current projections for late payments and interest costs are based on the number of leases that existed in our previous review (22,735 lease accounts as of July

31, 1978). As of September 30, 1980, Geological Survey maintained 26,769 lease accounts. Considering that the number of lease accounts has increased since the 1979 report, it is reasonable to assume the dollar amount of late payments is even greater than projected.

In our April 1979 report, we called for interest to be charged on late payments. Although agreeing to do so, Geological Survey has been slow in acting. Interest was not charged on late payments applicable to offshore leases until September 1980. The Geological Survey did not provide instructions for charging interest on late payments to its field offices handling onshore oil and gas leases until June 1981, and no interest has been collected for onshore late royalty payments as of July 15, 1981.

Geological Survey has taken the first step by issuing procedures for assessing interest on late payments. Interest should be assessed at the quarterly rate required by the Treasury for delinquent debts. Assessing of interest can essentially be automated with the computer identifying late payments and computing interest charges. But until an adequate automated system is developed, with the capability of identifying late payments and computing interest charges, the agency will be faced with having to provide additional staff to do the job manually. An action plan is needed to identify staff needs and resources. Otherwise we are doubtful as to whether interest will be effectively charged in the immediate future.

Insufficient auditing of lease account records

Besides needing to establish a reliable royalty collection system, the Geological Survey must increase its auditing and monitoring of lease accounts. Geological Survey's auditing and monitoring of its lease accounts continues to be inadequate to effectively control royalty payments. As previously reported, without sufficient lease account audits, the Geological Survey is in the position of having to rely upon unverified data reported by the oil and gas industry. Without a comprehensive

auditing program longstanding financial management problems will continue.

In our 1959 report, we pointed out the importance of having an auditing program to identify and resolve deficiencies in accounting for royalties. We repeated the importance of auditing in our 1979 report. Additionally, in 1975, the Department of the Interior internal audit staff recommended increased emphasis on the auditing of lease account records.

Geological Survey recognized the importance of conducting comprehensive audits by establishing criteria that audits be performed at intervals ranging from once a year to once every 6 years, depending upon the amount of annual royalties paid. As set out by Geological Survey, audits are to represent systematic and indepth investigation and appraisal of such things as reported production and sales; oil and gas values; royalties and rentals paid; and compliance with the lease terms, and oil and gas operating regulations. Lease accounts are to be reconciled to identify misapplied or missing charges, underpayments, and overpayments that appear or should appear in the account.

It has not followed through, however, and the situation today is essentially the same as it was in 1979. In fiscal year 1980, only 5 percent of the lease accounts were audited nationwide even though the audits have proven beneficial with additional collections of over $7.7 million. Geological Survey officials have acknowledged that audit efforts continue to be inadequate and they have not been able to audit enough accounts to achieve effective control over them. For instance, the Casper and Albuquerque offices, which are responsible for over 18,000 lease accounts, completed only 92 audits during 1979 and 1980. This means that over the 2 year period only 1/2 of 1 percent of the total accounts these offices were responsible for were audited. At this rate, the 18,000 lease accounts will never be completely audited. Even at the fiscal 1980 nationwide rate of 5 percent, it would take 20 years to audit the 18,000 lease accounts in the 2 offices.

At the time of our 1979 report, Geological Survey estimated that it would reconcile all leases by 1981. However, the task essentially has not even been started. Overall efforts by Geological Survey to improve monitoring and auditing of accounts have not been successful. Audit coverage is not sufficient in terms of numbers of accounts audited, nor does it provide assurance that accounts most needing audits will be included.

According to Geological Survey officials, audit and reconciliation requests from Indian tribes, Federal agencies, companies and individual lease operators occupy available audit staff resources, causing the already insufficient audit staff to audit accounts which have not been selected on a planned or systematic basis. Also other initiatives such as monitoring newly established accounts and reviewing accounts for obvious errors have not proven effective. As we have repeatedly pointed out, lease account problems can be eliminated or reduced if problems are discovered and resolved early in the life of a new account. The Albuquerque office assigned auditors to monitor newly established accounts but abandoned this effort because of higher priority work. Newly established accounts we examined during our current review exhibited the same deficiencies as the older accounts.

Geological Survey needs to develop a comprehensive systematic plan for reconciling, auditing and monitoring lease account activities and it must identify the additional resources needed to establish and maintain a continuing auditing program. Milestones for completion of the task are needed. In this regard, the Geological Survey is hiring 130 auditors. According to Geological Survey officials, the auditors will initially be used to explain the new royalty accounting system to the oil and gas companies. In addition, the Geological Survey is still not certain if this staff increase is sufficient to audit the 27,000 existing lease accounts. In order for the auditing program to be viable the auditors must adhere to the established program and should not be routinely used for other work.

GEOLOGICAL SURVEY IS MAKING AN EFFORT TO CORRECT ITS FINANCIAL MANAGEMENT PROBLEMS

Geological Survey, recognizing that its existing accounting system was inadequate, formed a task force to recommend system improvements. The task force recommended that a new royalty accounting system be designed and implemented. As you are aware, the system is not yet operational and will not be fully designed and implemented for several years.

Geological Survey completed a feasibility study and cost benefit analysis for a new system in March 1981. It plans to award a contract in September 1981 for design of the new system. The system will be implemented in three phases over a 5 year period. The three phases consist of (1) the royalty accounting phase, (2) the production phase, which will permit the matching of production and sales data, and (3) the enhanced management phase which will center on developing quality review and management data.

The Geological Survey refers to the new royalty accounting system as a modified IRS system, in that, all data submitted will be assumed to be correct subject to extensive computer analysis, screening, and audit. The agency currently estimates that the royalty accounting phase will be fully implemented by fiscal 1983 and the production phase by fiscal 1984.

Since the new system has not yet been designed and none of the phases is operational, it is difficult to say whether it will correct Geological Survey's longstanding financial management problems in the collection of oil and gas royalties. If the system is effectively planned, designed, implemented, and adequate resources provided, Geological Survey should be better able to account for and control royalty payments. Until then, however, it seems that Geological Survey will be hard-pressed to fully carry out its royalty collection responsibilities.

Historically, Federal agencies have experienced problems in designing and implementing financial management systems because sufficient management attention has been lacking. In

order that its new system does not succumb to the problems encountered by other agencies in designing and implementing new systems, Geological Survey must have a sustained, high priority effort — one with long term top management involvement. An effective accounting and financial reporting system will result only if top management within the Department of Interior and the Geological Survey remain involved.

In summary, Geological Survey has been slow in responding to its many longstanding financial management problems. At least 20 years have gone by since GAO first reported that the Geological Survey could not assure that all royalties due from Federal and Indian leases were being collected. The Geological Survey in its efforts to design and implement a new royalty accounting system is, for the first time, placing emphasis on the need for an effective royalty management program. The ongoing impetus to redesign the system must continue and improved royalty accounting must receive top management attention for the current program to succeed.

This concludes my prepared statement. We would be happy to respond to any questions.